VZCZCXRO9903
RR RUEHDBU RUEHLN RUEHPOD RUEHVK RUEHYG
DE RUEHMO #0334/01 0430953
ZNR UUUUU ZZH
R 120953Z FEB 09
FM AMEMBASSY MOSCOW
TO RUEHC/SECSTATE WASHDC 1875
INFO RUEHXD/MOSCOW POLITICAL COLLECTIVE
RUCPDOC/DEPT OF COMMERCE WASHDC
RHEHNSC/NSC WASHDC
RHEHAAA/WHITE HOUSE WASHDC

UNCLAS SECTION 01 OF 04 MOSCOW 000334

SENSITIVE
SIPDIS

STATE FOR EUR/RUS AND EEB/TPP/MTAA (NAFZIGER)
STATE PLS PASS USTR (MALMROSE, HAFNER, KLEIN)
COMMERCE FOR MAC (MATT EDWARDS, JAY THOMPSON)

E.O. 12958: N/A
TAGS: ECON EFIN ETRD WTO RS
SUBJECT: CRISIS-RESPONSE MEASURES FOR THE RUSSIAN CAR
INDUSTRY

REF: A. STATE 4753
¶B. MOSCOW 180
¶C. 08 MOSCOW 3745
¶D. 08 MOSCOW 3669

SENSITIVE BUT UNCLASSIFIED. NOT FOR INTERNET OR DISTRIBUTION
OUTSIDE USG CHANNELS.

SUMMARY

¶1. (SBU) Russia's car companies are heavily indebted and steadily losing market share to foreign competitors. The GOR continues to employ a range of state support measures to help Russia's major vehicle manufacturers cope with the global financial crisis, including direct financial support, subsidized lending and debt restructurings. A weakening ruble and increased duties on imported automobiles (Ref C) have provided some modicum of protection to domestic producers by making foreign cars more expensive. However, sales of Russian automobiles, what one critic called "scrap on wheels," remain low and with stockpiles increasing, some factories are beginning to cut production. As the financial crisis continues, the GOR's overarching concern will be avoiding the social unrest that might stem from massive layoffs at Russia's major car assembly facilities and at the upstream steel and metallurgical coal plants that supply them basic materials (Ref B). END SUMMARY.

¶2. (SBU) Per Ref A request, we summarize below the general actions that the GOR has taken to help Russia's car companies cope with the financial crisis, including increased duties on imported vehicles, and investment incentives for global car parts and components manufacturers who agree to set up production in Russia, a move that will indirectly benefit Russian car makers. We also summarize the situation at each major Russian car company, and the individual GOR support measures that have already been adopted or are being contemplated for each company. Finally, we assess the likely effect of these measures on sales and production.

Investment Incentives for Car Parts/Components

¶3. (SBU) Russian car makers will benefit indirectly from investment incentives that the GOR is now offering to global automobile parts and components manufacturers. As disclosed during Russia's WTO accession negotiations, because of quality problems and shortages of domestically produced car parts, Russia is now offering favorable investment terms to

multinational companies that apply to the Ministry of Economic Development (MED) to establish parts assembly and production within Russia. MED is currently considering 28 proposals, but has acknowledged that some of the deals may be abandoned or put on hold because of the financial crisis. For instance, in early February, Sumitomo and Czech firm Cadence canceled a $60-million joint venture production facility in St. Petersburg that was supposed to produce plastic car parts for Suzuki vehicles.

¶4. (SBU) Russian officials insist that these investment programs, and similar investment incentives previously offered to global car manufacturers, do not provide for mandatory local content requirements or run afoul of other international trading norms, though they do provide for preferential duty treatment as the percentage of local content in domestic assembly and production increases over time.

Increased Duties and Ruble Depreciation

¶5. (SBU) Russia's domestic car manufacturers have derived some benefit (see below) from recent duty increases on imported vehicles and the rapid depreciation of the ruble against the dollar and Euro, which have made foreign cars more expensive (Ref C). However, many observers believe that most Russian consumers will simply choose to save longer in order to buy a foreign car, rather than purchase Russian models that are widely viewed as unreliable and of inferior quality. As one Bank of Moscow analyst recently stated to

the media, the Lada Classic (produced by Avtovaz, Russia's leading car maker) is a piece of uncompetitive "scrap metal" that few Russian consumers want to buy.

Subsidized Loans and Government Procurement

¶6. (U) On February 10, the GOR announced two further support measures for domestic car makers. The first measure provides 2 billion rubles ($56 million) in 2009 for subsidized loans to consumers who purchase domestically produced cars with a purchase price less than 350,000 rubles ($9,722). The second measure provides for 12.51 billion rubles ($347 million) in GOR procurements of domestically produced vehicles through several ministries, including the Ministries of Defense, Internal Affairs (e.g., police cars), and Emergency Situations.

--- ----
Avtovaz: State-Owned Vehicle Losing Market Share
--- ----

¶7. (SBU) Avtovaz, Russia's largest car manufacturer, produces the iconic Soviet-era Russian brand "Lada" and engages in joint production ventures with Renault and GM. While the company's ownership structure is not fully transparent, Renault acquired 25% of the stock in 2008 and a small percentage of the stock is publicly traded. We believe that the largest block of shares is owned by Rostekhnologii and its affiliated companies, and Sergey Chemezov, the President of Rostekhnologii, is also Chairman of the Board of Avtovaz. Rostekhnologii is a state-owned conglomerate that also owns aviation assets, titanium production, and much of Russia's military-industrial complex.

¶8. (U) Avtovaz employs 104,000 workers at its production facilities in Tolyatti (population 705,000). The company's vehicle sales declined 6% in 2008 compared to 2007. (According to estimates from the Association of European Businesses, foreign car sales increased 26% in 2008 compared to 2007, while domestic car sales dropped 9%.) Avtovaz

produced nearly 740,000 cars in 2008, but as it lost market share to foreign car producers, it entered 2009 with an inventory overhang of over 110,000 vehicles (equivalent to more than two months' production). Avtovaz plans to produce only 600,000 vehicles in 2009. Avtovaz has laid off 400 of 1,200 workers producing the GM Niva (a sport utility vehicle) and has temporarily reduced its other productions lines to two shifts of six hours each. In early February, Avtovaz temporarily idled all of its production lines because of payment disputes with its suppliers (since January 1, it had been paying 30% cash and 70% in promissory notes on the accounts payable to its suppliers). However, the payments problems with suppliers were reportedly resolved, and the company resumed production on February 9.

¶9. (SBU) Rostekhnologii is one of only seven state-owned corporations that receive money directly from the federal budget, is only required to report financial results to the GOR once per year, and does not operate in a fully transparent manner. As such, it is entirely possible that Avtovaz could receive GOR money transfers via Rostekhnologii without any public disclosure of the support. In late 2008, Rostekhnologii received more than $5 billion in state support to weather the financial crisis, though, according to press reports, the GOR intended that much of the funds would be used to prop up the company's defense and aviation holdings, rather than Avtovaz.

¶10. (SBU) Rostekhnologii President Sergey Chemezov is reportedly now seeking an additional $7.22 billion in state support in the form of GOR capital contributions and state guarantees. If the GOR grants Chemezov's request, it is not yet clear how much of that funding will ultimately flow to Avtovaz. Avtovaz also announced that in March it would begin providing subsidized loans to consumers wishing to purchase the Lada and other Avtovaz models by using its own financial resources and those of two leading Russian banks, Sberbank and VTB. The company is also reportedly seeking buyers for its car dealership subsidiary, which accounts for roughly 25% of total sales, in order to raise about $150 million in cash.

GAZ: Badly in Need of a Bailout

¶11. (U) GAZ employs 115,000 personnel at its production facility in Nizhniy Novgorod (population 1.3 million). The company makes the Gazelle (an all-purpose delivery truck), has just launched the Volga Siber (a sedan that is similar to the discontinued Chrysler Sebring and is produced using old technology purchased from Chrysler), and also produces a few other light truck models. The company is owned by billionaire oligarch Oleg Deripaska, who has already received about $4.5 billion in GOR bailouts to aid his struggling metals businesses and to pay off his foreign creditors. Despite the overall strong demand for cars in Russia in 2008, GAZ's sales fell 25% in 2008 compared to 2007. GAZ is viewed as the most heavily indebted of Russia's auto makers, with at least $1.3 billion in debts, much of it reportedly in the form of short-term external borrowings that are due in mid-2009. Some press reports in January indicated that GAZ would have to lay off at least 25,000 workers if it were unable to secure GOR assistance. The company has temporarily gone to shorter work weeks and idled some production lines.

¶12. (U) On February 4, the GOR Anti-Crisis Committee chaired by First Deputy PM Shuvalov met to discuss how to assist GAZ through the crisis. The committee reportedly considered several options, including a restructuring of GAZ's debt, a GOR guarantee of the company's bank loans, bonds and commercial paper, or a GOR takeover of the company through a quasi-bankruptcy reorganization (while Russian bankruptcy law technically only allows for liquidations, the committee reportedly discussed a procedure that would be akin to a U.S.

Chapter 11 bankruptcy reorganization). Some committee participants told the press that GAZ would receive the lion's share of government procurements of Russian cars in 2009. The committee charged the Ministry of Economic Development with preparing a package of GOR support measures for GAZ by the beginning of March.

Sollers/UAZ: Least Vulnerable

¶13. (U) Sollers/UAZ employs 16,500 workers in Ulyanovsk (Lenin's home town, population 604,000) and 2,175 workers in Naberzhnye Chelniy (Republic of Tatarstan, population 506,000). The company is privately held by Vadim Shevtsov, a business associate of billionaire oligarch and Severstal owner Aleksey Mordashov. The company has fared better than Avtovaz and Gaz, because it has largely become an assembler of foreign economy class brands, including Fiat, Ssangyong and Isuzu, while still producing some Russian car and truck brands. In December 2008, Sollers reportedly received a 4 billion ruble ($111 million) credit facility from the state-owned bank VTB to help it through the crisis, and is reportedly seeking up to 6.1 billion rubles ($169 million) more to refinance debt and increase the company's working capital.

Kamaz: Captive Clients for Heavy Duty Trucks

¶14. (U) Kamaz is a heavy duty truck and bus manufacturer that has few consumer sales. Kamaz's main production facility is in Naberzhnye Chelniy, where it employs 72,000 workers. The company is owned by the state and a consortium of Russian banks, and its largest client is the Russian military. Despite the fact that the company does not operate in the consumer market and is to some degree insulated from direct competition with foreign truck producers because of state procurement contracts, in December 2008, it received a 7 billion ruble ($194 million) credit facility from state-owned bank VTB to tide it through the crisis.

COMMENT: STABILITY IS PARAMOUNT

¶15. (SBU) State support for the domestic car industry is more about ensuring stability in Russia's regions than about rescuing individual companies. The GOR is driven by a desire not only to save jobs in the car industry itself, but also to avoid layoffs at upstream steel and metallurgical coal

facilities that supply basic materials to the industry. Many of Russia's car makers and their upstream suppliers are the single-largest employers in the medium-sized cities where they are located, and a shuttering of their plants would have a devastating impact on local and regional unemployment figures. As Russia's domestic car makers continue to cope with eroding market share and weak consumer demand, we expect that the GOR will employ all means necessary to avoid massive layoffs and the social unrest that might ensue (Ref B).
BEYRLE